

Section II Production

Chapter 12

LIHTC and other Tax Credit Program Guidance

12.1

Introduction

The Low Income Housing Tax Credit (LIHTC) program was enacted as part of the Tax Reform Act of 1986 and is administered by the Treasury Department and the State Housing Finance Agencies (HFAs). In July 2008, the Housing and Economic Recovery Act (HERA) was enacted which made changes to FHA programs to facilitate the use of FHA-insured mortgages with LIHTC developments.

This chapter outlines the policies and procedures to follow when underwriting and reviewing FHA mortgage insurance applications referenced under Title II of the National Housing Act with tax credits. Standard processing of applications apply except as modified below as well as within Production, Chapters 5, 9 and 11 of this Handbook.

All provisions of this Handbook applicable to LIHTC are also applicable to Historic and New Markets tax credit equity projects, to the extent consistent with the Section 232 program.

12.2

Program Guidance

A. Use of Tax Credits with the FHA-Insured Mortgage:

1. The Firm Application for any LIHTC project should include evidence of the LIHTC award or allocation.

1-2. Government tax credits, combined with any secondary financing and grants, may be used to cover up to 100% of the equity requirement. Regarding secondary financing, see requirements and limitations in Production, Chapter 3, at 3.15.

2-3. Secondary financing, grants, and government tax credits may also be used to finance non-mortgageable costs. Such funds covering non-mortgageable costs, when added to the FHA-insured mortgage and required equity contribution, may exceed 100%

of the project's Fair Market Value (FMV) or Replacement Cost.

3. ~~4.~~ Non-mortgageable costs or replacement cost items required to complete the project may be included in the application-transaction with supporting documentation, subject to ORCF approval.

5. Publicly Funded Loans or Public Debt. Loans funded with HOME Funds or other federal, state or local public sources, as well as those funded by quasi-public agency programs, may be granted or lent directly to HUD's borrower, or to the GP or sponsor of the borrower, who will then loan it to HUD's borrower. All such sources will be treated as public secondary financing sources, and as such need not be included in the calculation of the total project cost limit applied to private secondary debt. However, none of these sources may be substituted for tax credit equity required by the pay-in schedule.

6. Tax Exempt Bonds/Take out by FHA Insured Permanent Debt. Tax credit projects are often financed with the "4%" tax credits allocated in conjunction with private activity bond volume cap. Taxable Ginnie Mae securities' yields and the resulting rates on FHA loans at times can be lower than tax exempt bonds and municipal bond-backed loan rates. Consequently, investment banks have developed an approach that combines taxable Ginnie Mae securities with short term, tax exempt bonds and 4% LIHTC. This structure establishes several different account funds, along with a series of cash flow events between the various accounts upon a draw request. The tax exempt bonds are secured by cash collateral initially provided by the FHA lender's warehouse funds (or other funding source, but not FHA-insured loan proceeds), which in turn are reimbursed with proceeds from the sale of Ginnie Mae-guaranteed securities. The tax exempt bonds are retired with the proceeds of the bond collateral account when the project is placed into service.

This structure allows the borrower to avoid higher loan rates that exist when the loan funding source consists exclusively of tax exempt bonds, and still take advantage of the 4% LIHTC equity. This bond financing structure is generally acceptable to HUD, but each transaction must be reviewed by HUD for programmatic and legal sufficiency, including the review of specific transaction documents.

Note that FHA-insured loan proceeds shall not be used to serve as collateral for the bonds, and they may not be paid to the bond trustee or sent to other accounts to facilitate issuance of the bonds. This is a statutory prohibition that may not be waived, as FHA-insured loan proceeds are only permitted to directly finance the relevant activity authorized under the applicable section of the National Housing Act. To ensure statutory compliance regarding the use of FHA-insured loan proceeds, HUD requires lenders to sign and submit the "Lender Certification for Tax Exempt Bond and 4% Low Income Housing Tax Credit Transactions" for financings structured in this manner.

4-7. Borrowers using LIHTC or other government tax credit programs must demonstrate successful experience in developing and owning comparable regulated properties.

5-8. If a tax credit syndicator is identified, the Lender's Underwriter will also need to provide a brief overview and analyses of the entity. Typically a tax credit syndicator is an investor intermediary with only a limited ongoing obligation to LIHTC rental properties. ~~Accordingly~~ Nevertheless, the syndicator's liquidity, track record, asset management and monitoring capability and ability to perform on its commitment to provide equity to the Borrower after Initial Closing is a material issue for the experience and creditworthiness analysis of the tax credit investor/LP.

6-9. For LIHTC projects with a funded working capital reserve held by the partnership (even though controlled by the syndicator or investor and not by HUD or the Lender), the funded reserve will be credited towards the increased construction reserve requirement, although the Lender controlled account must still meet the 2% working capital escrow requirement.

7-10. For LIHTC projects with a funded operating deficit reserve held by the partnership (even if controlled by the investor and not by HUD or the Lender), the funded reserve will be credited towards the reserve requirements of the mortgage, although the Lender controlled account must still meet what the appraisal and underwriting analysis determines to be an appropriate operating deficit amount.

B. Tax Credit Equity Bridge Loans:

1. ~~Tax credit equity syndicators or investors (with or without an Identity of Interest with the Lender which may, subject to the restrictions in Section 12.2(D) of this Chapter, have an identity of interest with Lender) may make equity bridge loans to LIHTC, Historic or New Markets Tax Credit projects during the construction or substantial rehabilitation period before the property's placed-in-service date, as defined by the applicable tax credit program. The bridge loan may be evidenced by a promissory note from the sponsor and may be secured by a pledge of the tax credits or of the limited partnership interest but may not be secured by a lien on the real estate. After the placed-in-service date, the bridge loan must be released and retired by the pay-in of the investor's equity.~~

2.

~~Bridge loans may be used by tax credit investors to defer the pay-in of equity during a project's development and stabilization phases, thereby increasing the return on equity. An equity bridge loan is a means of securing the sponsor's cash contribution that is required to complete construction before the LIHTC's are available to be claimed by the equity investor. The placed-in-service date is the date when the newly constructed or rehabilitated property has been completed and its units have been occupied by income-qualified tenants. This is also when the LIHTC are officially able to be claimed by the equity investor, and is evidenced by issuance of IRS form 8609. The placed-in-service~~

119 ~~date will typically be after Final Closing of the mortgage.~~ However, at ~~F~~final ~~C~~closing, all funds needed to
120 meet the ~~sponsor's borrower's~~ cash contribution must be in the transaction so the sources and uses will
121 balance and the ~~LHFC~~ investors will pay in the equity to retire the equity bridge loan ~~at the later placed~~
122 ~~in-service date.~~

123 The bridge loan may be the obligation of one or more of the investors or other upper tier
124 partners to the ownership entity (e.g. the limited or general partners), or an obligation of
125 the project ownership entity/single-asset mortgagor itself. In addition the following
126 conditions must be met:

127 1. The equity bridge loan may not be secured by a lien on the real estate or on any
128 other real or personal property that is collateral for the FHA insured loan, as defined in the
129 Security Instrument, although they may be secured with a pledge of tax credits and/or of
130 limited partners' or investor members' interests in the project's ownership entity;

131 2. The equity bridge loan must be non-recourse to the Borrower, and the bridge lender
132 shall have no claim even in an event of default against the Borrower, the Project, FHA
133 mortgage loan proceeds, or any reserve or deposit made with the FHA Lender, or
134 otherwise required by HUD;

135 3. In the event HUD acquires title to the Project by foreclosure or deed in lieu of
136 foreclosure, the bridge loan documents automatically terminate and the Borrower shall be
137 released of all of its obligations with respect to the equity bridge loan;

138 4. The obligation must be evidenced by a promissory note;

139 5. The term of the note may last through the construction or rehabilitation period but
140 must be paid in full no later than final closing.

141 6. At application, or as soon as the need for a bridge loan is known, the lender must
142 submit a term sheet describing the key terms of the bridge loan, as well as a certification
143 that a) the loan will be secured only by a pledge of partnership interests or tax credit
144 benefits and not by the project, and b) that the bridge lender will have no claim against the
145 mortgaged property, mortgage proceeds, any reserves or deposits, or against the rents or
146 other income from the property for repayment of the bridge loan.

147 7. Bridge loans for other purposes, (i.e. that are not used to advance equity in tax
148 credit projects) are described in Chapter 3.

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151
152 **C. Tax Credit Equity Contribution:**
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- 154 1. ORCF requires that an appropriate amount of the tax credit equity be invested in
155 the project and be applied to ORCF-approved items at the time of initial closing.
156 The amount deemed by ORCF to be sufficient for such purposes will depend on
157 the circumstances of each transaction, but must be an amount that assures an
158 ongoing relationship between the Borrower and the tax credit syndicator or
159 investor.
160
- 161 2. The initial installment of equity must be an amount that is equal to or exceeds
162 twenty percent (20%) of the total equity that will be available for the project. If
163 less than 20% is proposed, the Lender must submit a request for ORCF review
164 and approval. ORCF will review the justification submitted to determine if the
165 lesser amount is appropriate as an initial investment of equity.
166
- 167 3. The Commitment for Mortgage Insurance will contain, among other special
168 conditions, a requirement for evidence satisfactory to ORCF of an agreement that
169 binds the investor to timely and periodically pay the Borrower tax credit equity to
170 contribute to the completion costs, in the aggregate amounts shown on the
171 Applicant/ Recipient Disclosure/Update Report (Form HUD-2880). An equity
172 pay-in schedule, with actual total equity and net-equity amounts, must be included
173 as a special condition and attachment to the Firm Commitment for all tax credit
174 Projects. This schedule will be used as a method of checking proposed
175 disbursement schedules. For example, a contribution schedule might require the
176 2nd installment of LIHTC Equity to be contributed at 50% construction
177 completion, the 3rd installment at 75% construction completion, a 4th installment
178 required to complete construction and pay third party soft costs, exclusive of
179 developer's fee, by 90% construction completion, with the final infusion of
180 LIHTC Equity, which contains any deferred developer's fee, after 12-24 months
181 of sustaining occupancy.
182
- 183 4. The actual amount of the initial equity investment must be reflected in the Firm
184 Commitment as a special condition with the requirement that the initial
185 installment must be expended on the initial requisition at Initial Closing.
186
- 187 5. After the first installment of LIHTC-tax credit Eequity is distributed at initial
188 closing, the subsequent contributions shall be made at a time and in a manner
189 during construction to ensure that the underwriting requirements in the Firm
190 Commitment are maintained and met for actual costs. To maintain the
191 appropriate balance of LIHTC-tax credit Eequity and mortgage loan proceeds, at
192 each infusion of LIHTC-tax credit Eequity those funds may need to be utilized
193 before the next disbursement of mortgage loan proceeds.

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195 **D. Sponsor's Continuing Commitment:**
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- 197 1. In the case of LIHTC or Historic Tax Credit transactions, to the extent consistent with
198 the Section 232 program, the application must include a *Letter of Commitment* to fund
199 the required equity from a tax credit equity syndicator or investor. This *Letter of*
200 *Commitment* must specify the equity amount, pay-in schedule and other relevant
201 details such as conditional benchmarks so that HUD and the Lender can ensure
202 sufficient equity in a manner that meets HUD's requirements. The Lender may also
203 make the determination to require additional documentation (e.g. financial statements,
204 etc.) of a syndicator or investor.
205
206 2. The Lender must focus on and evaluate the LIHTC syndicator's or the direct
207 investor's financial strength, experience, reputation and asset management
208 capabilities, if they have the majority ownership interest in the Borrower entity.
209 Evaluating the syndicator is important because investors expect syndicators to support
210 transactions that have cash flow problems or replace nonperforming general partners.
211 In addition, the syndicator must typically assess the appropriate amounts of reserves
212 at both the property and fund levels and must perform certain asset management
213 functions.
214

215 **E. Identity-of-Interest:** An affiliate of the Lender ~~can be the tax credit equity syndicator or~~
216 ~~investor and~~ can own up to a 25% percent interest in the ~~99%~~ investor limited partnership
217 ~~interests~~ (or invester LLC membership interests ~~an equivalent percentage if owned as an~~
218 ~~LLC~~) entity of the Borrower, under the following conditions:
219

- 220 1. In all instances where there is an identity of interest or affiliation between the Lender
221 and the tax credit equity syndicator or investor, ~~:-a)~~ the loan must be processed,
222 underwritten and approved by the Lender staff without involvement by the affiliated
223 equity staff.
224
225 2. The affiliated tax credit equity syndicator or investor can hold no more than a 25%
226 interest in the limited partnership entity (or an equivalent percentage if owned as an
227 LLC) of the Borrower after the project's placed-in-service date. During the
228 construction or rehabilitation period before the property's placed-in-service date, the
229 tax credit equity syndicator or investor may make an equity bridge loan that complies
230 with Section 12.2.B ~~to the project that may be evidenced by a promissory note from~~
231 ~~the sponsor, which may be secured by a pledge of the tax credits or of the limited~~
232 ~~partnership interest but which may not be secured by a lien on the real estate~~. After
233 the placed-in-service date, the affiliated tax credit equity syndicator or investor may
234 not hold an equity bridge loan note and may not own more than a 25% interest in the
235 limited partnership entity of the Borrower.
236
237 3. ORCF must ensure that the affiliated tax credit equity syndicator or investor does not

improperly influence the Lender on a LIHTC project. Therefore, the Lender and the affiliated tax credit equity syndicator or investor must provide ORCF with a specific Representations and Warranties on applications submitted for each LIHTC project.

a. The Lender's Representation and Warranty must state:

- i. No officer or employee of _____ (insert the name of affiliated tax credit syndicator or investor) or any director or parent thereof will have any loan-specific or decision making control or influence in _____'s (insert the name of Section 232 Lender) underwriting of the FHA-insured mortgage except by providing factual information to _____ (insert the name of Lender) in the same manner as would be provided by an unaffiliated syndicator).
- ii. _____ (insert the name of Lender) will not condition its agreement to provide such financing on _____ (insert the name of affiliated tax credit equity syndicator or investor) being selected as the tax credit equity syndicator or investor for the project to be financed by the FHA-insured mortgage.
- iii. _____ (insert the name of the Lender) will notify HUD promptly, in writing, during application processing of any change or event which causes the foregoing Representation or Warranty to be materially untrue or inaccurate.

b. The Lender's affiliated tax credit syndicator or investor's Representation and Warranty must state:

- i. In the regular course of its business it syndicates or invests in tax credit equity investments in assisted living affordable housing projects.
- ii. With respect to any project loan that is to be underwritten by _____ (insert name of Lender) and in which _____ (insert name of affiliated tax credit equity syndicator or investor) intends to make an equity investment or sell equity to other investors:
 1. No officer or employee _____ (insert name of Lender) will have any loan-specific control or influence in _____'s (insert name of affiliated tax credit equity syndicator or investor) processing of the sponsor's application for tax credit equity syndication or investment except by providing factual information to _____ (insert the name of affiliated tax credit equity syndicator or investor) in the same manner as would be provided to an unaffiliated Lender.
 2. _____ (insert the name of affiliated tax credit equity syndicator or investor) will not condition its commitment to syndicate or invest in the project equity on debt

financing for such project being provided by _____
(insert the name of Lender).

3. Except during the interim period prior to the placed in service date during which _____ (insert name of affiliated tax credit equity syndicator or investor) may make an equity bridge loan to the project, neither _____ (insert the name of affiliated tax credit equity syndicator or investor) nor any affiliate or subsidiary thereof will hold greater than a 25% interest in the 99% investor limited partnership entity (or an equivalent percentage if owned as an LLC) of the Borrower.

4. The Representations and Warranties must include the following criminal warning language: **WARNING:** *“HUD will prosecute false claims and statements. Convictions may result and/or civil penalties. (18 U.S.C. 1001, 1010, 1012; 31 U.S.C. 3729, 3802)”*

~~E.~~

- F. Subsidy Layering Review:** Tax credit equity solely in combination with FHA-insured debt is exempt (by the Housing and Economic Recovery Act of 2008 (HERA)) from a subsidy layering review. Beyond the FHA-insured debt, a subsidy layering review is required when other public funds are combined. In every case, regardless of the sources of supplemental public grant, loan, or equity funds, the Lender must review the Sources and Uses statements for both mortgageable and non-mortgageable funds to ensure costs are not being funded twice, and that costs funded directly or indirectly from mortgage proceeds are appropriate and necessary to complete the transaction.

G. Tax Credit Regulatory Agreements. In tax credit projects, certain IRS Section 42 obligations must be allowed to continue post-default. Generally, however, for the Tax Credit Land Use Restriction Agreement (LURA), and/or when public secondary financing with regulatory agreements or restrictive covenants are required, HUD requires the use of its standardized rider, indicating that in case of conflicts between a LURA or another restrictive covenant and FHA "program obligations," FHA requirements take precedence. Alterations of the rider that are once approved for certain jurisdictions may then be used as the template for that jurisdiction, with prior ORCF approval. It is the lender's responsibility to draw attention to potential conflicts between FHA requirements and the LURAs or other restrictive covenants in the Firm application submission. If they are not addressed in the Firm Commitment, the lender should assume the closing will be delayed.

12.3

Firm Commitment and Initial Closing

- A. The Firm Commitment will include special Firm Commitment conditions to confirm and

321 assure the Tax Credit Equity requirements stated in Section 12.2:

- 322
- 323 1. That the Commitment is subject to, and has been issued upon the reliance of, the
324 receipt of Low Income Housing Tax Credit (Historic Tax Credits or New Market Tax
325 Credits) syndication funds in the amount of \$ of which a \$ cash
326 investment is required for mortgageable items including land and \$ for HUD
327 required escrows. The initial installment of funds allocated to mortgageable items
328 must be provided prior to initial closing, with a disbursement agreement that
329 evidences the timely infusion of funds required to pay for all project costs. All
330 documents relating to the tax credit funds, including the Land Use Restriction
331 Agreements, the final statement of sources and uses, and the final Applicant/
332 Recipient Disclosure/Update Report, must be reviewed and approved by ORCF prior
333 to initial closing.
334
 - 335 2. HUD's review and determination of acceptability and sufficient financial capacity is
336 required for the tax credit investor(s). This investor entity and all principals are
337 subject to Previous Participation clearance requirements, except to the extent limited
338 liability corporate investors may submit an LLCI certification in lieu of other
339 previous participation requirements. HUD approval of the final investor(s) must be
340 accomplished prior to initial closing.
341
 - 342 3. The Borrower's organizational documents must include a provision that prohibits any
343 changes to the organization documents that affect the investor commitment without
344 the written consent of the Lender and HUD.
345

346 **B. Initial Closing:** Prior to initial closing, HUD will review and approve all proposed closing
347 documents to ensure compliance with all firm commitment obligations and Special
348 Conditions. Specific to loans involving tax credits, the initial closing documents must
349 include:
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- 351 1. A final detailed Sources and Uses statement of total development costs, reflecting any
352 revisions to hard and soft costs as reflected on the firm commitment, HUD-92264a-
353 ORCF. If any funding sources have changed, a revised Applicant/ Recipient
354 Disclosure/Update Report is also required.
355
- 356 2. Tax credit syndicator and investor documents. The Partnership Agreement or other
357 investor documents of the syndicator, including:
 - 358 a. Consolidated Certifications,
 - 359 b. Previous Participation certifications,
 - 360 c. Modified credit package to include current financial report or Annual Report,
361 as applicable.
362
- 363 3. Evidence that the FHA-Insured Mortgage will be in first lien position with respect to
364 all project collateral.

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4. All documents shall include conflict language giving the HUD documents supremacy over other documents. Documents may not include indemnification provisions, except as otherwise permitted by outstanding HUD guidance.

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